

Because the BOCs control the local exchange network and the provision of basic services, in the absence of regulatory safeguards they may have the incentive and ability to engage in anticompetitive behavior against ISPs that must obtain basic network services from the BOCs in order to provide their information service offerings. For example, BOCs may discriminate against competing ISPs by denying them access to services and facilities or by providing ISPs with access to services and facilities that is inferior to that provided to the BOCs' own information services operations. BOCs also may allocate costs improperly by shifting costs they incur in providing information services, which are not regulated under Title II of the Act, to their basic services.

Unless adequate safeguards are adopted that would give unaffiliated entities the opportunity to provide advanced services on a competitive basis, the ILECs could become the dominant providers of advanced services, including Internet access.

ILECs will be constrained in their ability to monopolize the advanced services markets only if: (a) there exists robust, widespread, and sustainable facilities-based competition for "last-mile" (*i.e.*, local loop) access that is sufficient to limit ILEC market power and encourage ILECs to freely interconnect with alternative advanced services providers, or risk significant loss of market share; or (b) other advanced services providers have nondiscriminatory access to ILEC bottleneck facilities at prices that are economically correct and equal to those paid by the ILECs' advanced services affiliates.³⁹ In light of the limited inroads CLECs have made into ILECs' markets, even two years after the Commission

³⁹ In this regard, "nondiscriminatory access" should be applied literally, that is, any non-affiliated advanced services provider would have precisely the same access to the ILEC's underlying infrastructure, including DSL electronics, as would the ILEC or its advanced services affiliate.

adopted the *Local Competition Order*,⁴⁰ it is highly unlikely that the first scenario will occur in the foreseeable future on any widespread basis, *i.e.*, outside of a few highly concentrated niche markets. The more distant future may be another matter.

At some point in the future, cable television companies will likely provide a realistic alternative to the ILECs' last-mile connections. However, the broad deployment of broadband cable-based data services (via cable modems) may prove quite costly, and it remains uncertain whether cable companies will undertake the investment necessary to upgrade their systems soon enough to challenge the ILECs' last-mile monopoly in the near term. But facilities-based competition for the provision of "last mile" access via an alternative infrastructure may not be essential for a competitive advanced services market, provided that effective, meaningful safeguards against ILEC market power are in place and rigorously enforced. It is crucial to the development of competition in both advanced services and information services markets that the Commission adopt effective measures that will curb ILECs' opportunities for anti-competitive conduct and allow new providers to enter the advanced services markets on fair terms.

The Commission's proposal to give ILECs the option of providing advanced services on either an integrated or separated basis should help create an environment in which competing advanced services providers may obtain the ILEC facilities and functionalities they need. The Commission, however, should not assume that its proposal will be sufficient to stimulate competition and deter

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Supra, note 19.

anti-competitive conduct. Rather, the Commission should consider additional pro-competitive safeguards and monitor the development of the advanced services market.

For example, the Commission should consider that an ILEC may attempt a "price squeeze" to make it more difficult for competitors to enter the market. It should adopt safeguards that recognize and protect against such conduct. Under the separate subsidiary scenario, there exists a clear potential incentive for an ILEC to effectuate a "price squeeze," whereby it overcharges competitors for access to necessary network facilities and functionalities (or imposes artificial and unnecessary technical and physical requirements upon competitors for such access⁴¹) and/or undercharges its own customers for its advanced services.

Even if ILECs are required to charge their competitors the same rates they charge their separate subsidiaries, if those rates are inflated, competitors may be unable to afford the facilities and functionalities they need, while the ILECs' affiliates would not ultimately be disadvantaged since the transactions would take place within the same corporate family.⁴² Thus, the Commission should require ILECs to set rates for network facilities and functionalities that are economically rational and cost-based, and should prevent ILECs from establishing provisioning

⁴¹ For example, the ILEC may limit the types of equipment that a non-affiliated competitor may place within its collocation space in the ILEC's central office, may impose additional cross-connect requirements and costs, may prohibit or restrict interconnections among collocation spaces of individual non-affiliated providers, and/or may impose excessive and unnecessary charges and fees for the collocation arrangements themselves.

⁴² ILECs whose earnings are not subject to any sharing requirement or earnings cap may overcharge affiliates without flowing the excess profits back to monopoly service ratepayers, as would be required under a revenue requirement-based rate of return form of regulation. ILECs thus have every incentive to engage in such transfer pricing practices if by so doing their rival's costs can be elevated.

arrangements whose operation and effect is to create additional costs for competing providers that the ILECs' own advanced services affiliates can evade.⁴³

To complement these proposals, or perhaps as an alternative to them, the Commission should adopt several of its proposed safeguards regarding transfers of assets or services between ILECs and their affiliates. Specifically, the Commission should adopt its proposed requirements⁴⁴ that: (1) transactions between ILECs and their affiliates must be on an arms' length basis; (2) all assets and/or services transferred and the terms and conditions of such transactions, must be detailed in writing and made publicly available, including on the Internet, within 10 days; (3) ILECs must not discriminate in favor of their affiliates in the provision of goods, services, facilities, or information, or in the establishment of standards; (4) ILECs must interconnect with their affiliates pursuant to agreements or tariffs, and must offer unaffiliated entities the same network elements, facilities, interfaces, and systems the ILECs provide to their affiliates; and (5) all transactions between ILECs and their advanced services

⁴³ Of course, any action the Commission is considering regarding the rates ILECs may charge should be carefully crafted to comply with the jurisdictional limitations on the Commission's rate-setting authority, as established in *Iowa Utilities Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997).

⁴⁴ NPRM at ¶ 96.

affiliates will be subject to the Commission's affiliate transactions rules,⁴⁵ as modified by the *Accounting Safeguards Order*.⁴⁶

As the Commission noted in the NPRM, the proposed transaction reporting requirements should assist new entrants in detecting whether they are receiving the same treatment from the ILECs as the ILECs' affiliates.⁴⁷ Equal treatment by the ILECs of their affiliates and their competitors will be critical to the competitive provision of advanced services.

Improper ILEC cross-subsidies are addressed by the Commission's proposal to apply the affiliate transactions rules to transfers of assets and services between ILECs and their affiliates. Those rules require that ILECs record asset transfers between them and their affiliates into or out of regulated accounts and service transfers between them and their affiliate in the ILECs' appropriate revenue accounts.⁴⁸ These transactions must be recorded at either: (1) the applicable tariffed rate, if one exists; (2) if not tariffed, the rate in the applicable agreement or statement of generally available terms filed publicly under Sections 252(e) and 252(f) of the Act;⁴⁹ (3) where the ILEC has transferred more than 50% of an asset or service to third parties, the "prevailing price";⁵⁰ and

⁴⁵ 47 C.F.R. § 32.27.

⁴⁶ *Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996*, CC Dkt. No. 96-150, 11 FCC Rcd 17539, 17593 (1996) ("*Accounting Safeguards Order*"), *recon. pending*, NPRM at ¶ 96 & n. 189; *see id.* at 111 & n.207.

⁴⁷ NPRM at ¶ 96.

⁴⁸ 47 C.F.R. §§ 32.27(a), (b).

⁴⁹ 47 U.S.C. §§ 252(e), (f).

⁵⁰ 47 C.F.R. § 32.27 (b), (c), (d).

(4) in all other cases, (a) where the transfer is from the ILEC to its affiliate, at the higher of fair market value or net book cost,⁵¹ and (b) where the transfer is from the affiliate to the ILEC, at the lower of fair market value or net book cost.⁵²

Application of the affiliate transactions rules to the ILECs and their advanced services affiliates should, as the Commission has postulated, be "sufficient to discourage, and facilitate detection of, improper cost allocations in order to prevent incumbent LECs from imposing the costs of their competitive ventures on telephone ratepayers."⁵³

A complementary measure that the Commission should consider is to require that a minority of the equity of an ILEC advanced services subsidiary be held by entities unaffiliated with the ILEC. This will limit the ILEC's potential motivation to engage in self-dealing or to unfairly benefit its subsidiary, and guarantee that independent parties have a financial interest in ensuring that the ILEC does not abuse the parent-subsidiary relationship. While Ad Hoc cannot definitively quantify the optimal percentage of outside ownership, it should be sufficiently large to discourage anti-competitive self-dealing. Such a provision should discourage the ILEC parent from contributing assets or furnishing services on a below-cost basis, and should additionally discourage the parent from acquiring capital assets or services from the subsidiary at above-market value prices.

⁵¹ In the case of transferred services, the amount recorded must be the higher of fair market value or fully distributed cost. *Id.*, § 32.27(c).

⁵² In the case of transferred services, the amount recorded must be the lower of fair market value or fully distributed cost. *Id.*

⁵³ NPRM at ¶ 96.

Moreover, any entity that provides advanced services on a common carrier basis and *a//* ILEC advanced services subsidiaries should be subject to Sections 201, 202, and 208 of the Communications Act.⁵⁴ But in the absence of an advanced services provider having market power, the Commission may forbear from imposing regulatory requirements on advanced services providers. The Commission should make it clear that, in the absence of market power, advanced services providers would not be precluded from offering such services on a contract, or private carriage, basis.

The Commission should adopt the proposals it has made to increase collocation opportunities at ILEC offices. In particular (but without limitation), the Commission should require ILECs to offer competitors the same collocation opportunities the ILECs offer their advanced services subsidiaries on nondiscriminatory terms and conditions;⁵⁵ allow cageless or other space-saving collocation;⁵⁶ establish guidelines or rules to reduce the cost of collocation;⁵⁷ and offer competing advanced services providers optional payment terms for large non-recurring fees.⁵⁸ In addition, the Commission should allow collocation of

⁵⁴ 47 U.S.C. §§ 201, 202, 208.

⁵⁵ The Commission has proposed adoption of this requirement. NPRM at ¶ 129.

⁵⁶ The Commission has tentatively concluded that it should require ILECs to offer such collocation opportunities. *Id.* at ¶ 137.

⁵⁷ The Commission has stated that ILECs have a statutory obligation to offer cost-efficient collocation, and that it expects ILECs to take steps to reduce unnecessary collocation costs for competitors. *Id.* at ¶ 64. It has also requested proposals for reducing rates for collocation, and it has stated that any national pricing standards it may adopt would be only minimum standards, leaving the states with the flexibility to adopt additional requirements. *Id.* at ¶ 143.

⁵⁸ The Commission's Order approving the merger of Bell Atlantic and NYNEX required those carriers to offer CLECs similar alternative payment arrangements for certain charges

switching equipment and enhanced services equipment (*e.g.*, routers and protocol processors).⁵⁹

The Commission should reiterate that ILECs providing advanced services must provision conditioned loops and other UNEs to competitive advanced services providers (and perhaps ISPs⁶⁰) on a nondiscriminatory, timely basis.⁶¹ It should also confirm that ILECs' separate subsidiaries must comply with the interconnection and related obligations of Sections 251(a) and 251(b).⁶² The Commission might consider mandatory time periods for provisioning, enforced

associated with establishing interconnection arrangements with the merged ILECs. *Applications of NYNEX Corporation and Bell Atlantic Corporation for Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries*, File No. NSD-L-96-10, Memorandum Opinion and Order, 12 FCC Rcd 19985 (released Aug. 14, 1997) ("*NYNEX Merger Order*") at 20073-74, 20078 & Appendix C.

⁵⁹ The Commission has tentatively concluded that it should permit collocation of switching equipment, NPRM at ¶ 129, but it has tentatively decided to continue its policy of not requiring collocation of enhanced services equipment. *Id.* at ¶ 132.

⁶⁰ The Commission has noted that, in the *Computer III Further Remand* proceeding, *supra*, note 19, it is considering whether to extend the benefits of Section 251-type obligations to ISPs. NPRM at ¶ 142 & n.266.

⁶¹ The Commission has already determined that the obligations of Sections 251 and 252 -- including the interconnection obligations of Section 251(c)(2), the obligation to furnish UNEs under Sections 251(c)(3) and 251(d)(2), and the resale obligations of Section 251(c)(4) -- apply fully to advanced services that ILECs provide directly. MO&O, *supra*, note 2, at ¶¶ 11, 18, 32. The Commission has also ordered that the equipment and facilities ILECs use to provide advanced services are network elements, subject to Section 251(c); thus, ILECs must provide new entrants with unbundled loops capable of transporting high-speed digital signals and unbundled access to the other equipment the ILEC uses to provide advanced services, to the extent technically feasible and subject to Section 251(d)(2). MO&O at ¶ 18.

⁶² The Commission has noted that ILECs' advanced services affiliates would be subject to the interconnection obligations that Section 251(a) imposes on all telecommunications carriers and to the additional obligations that Section 251(b) imposes on all local exchange carriers. NPRM at ¶ 92.

through reporting requirements, the Section 208 complaint process, and other mechanisms to guard against discriminatory or untimely provisioning.⁶³

In addition, the Commission should require all ILECs to give ISPs⁶⁴ and "data competitive access providers" ("D-CAPs") unbundled access at the ILECs' switch locations to aggregated data traffic from the ILECs' customers at cost-based, economically efficient rates.⁶⁵ Because voice and data services are provided over the same ILEC facilities, ILECs are able to maintain their control over access to customers whom D-CAPs and unaffiliated ISPs would like to serve. If a D-CAP does not wish, or lacks the facilities needed, to provide voice local exchange service, it may practically be foreclosed from providing a meaningful alternative to the ILEC's advanced and/or information services. D-CAPs and ISPs that purchase this type of service from the ILECs should not be required to provide local exchange service pursuant to Section 251, since they will be providing only specialized advanced data and/or information services that are not substitutable for the local exchange voice and data services that ILECs offer.

The unbundled access to aggregated data traffic proposed above could limit the ability of ILECs to leverage their control of the local loop to discriminate

⁶³ The Commission has already imposed safeguards similar to these on Bell Atlantic and NYNEX. *See NYNEX Merger Order*, *supra*, note 67, 12 FCC Rcd at 20071-72, 20076-78 & Appendices C & D.

⁶⁴ *See supra*, note 69.

⁶⁵ This proposal has been advanced by a number of commenters in varying degrees of specificity in response to the *Computer III* Further Notice, *supra*, note 19. *See, e.g.*, MCI Comments (filed Mar. 27, 1998) at 68-69; Information Technology Association of America Comments (filed Mar. 27, 1998) at 27-31; America On Line Comments (filed Mar. 27, 1998) at 16-18.

against competitors. Because competing advanced services and information services providers would be able to serve their customers without having to furnish last-mile service, the ILECs' control over last-mile facilities would be less of a threat to advanced services competitors.

To implement this recommendation, the Commission should require ILECs to provide spectrum unbundling upon request and on reasonable, nondiscriminatory terms and conditions. Spectrum unbundling facilitates the joint, simultaneous use of the local loop by the ILEC (to offer voice service) and by a competing provider (to offer advanced data services). Adoption of spectrum unbundling requirements is, therefore, an important tool to minimize the anticompetitive impact of the ILECs' control of the local loop.

Supporting a competitively neutral regulatory environment to encourage the deployment of advanced services in no way implies that the incumbents should be disadvantaged relative to new competitors. ILEC deployment of advanced services, whether on an integrated or separate subsidiary basis, should not be hampered by unnecessary rate regulation, and ILECs should not be compelled to offer competitors conditioned loops for less than their cost to prepare the loops were the ILECs to offer the service themselves. Moreover, Ad Hoc agrees with the Commission that ILECs offering service via the separate subsidiary option should not be required to offer any of the subsidiary's services or equipment as unbundled elements,⁶⁶ provided of course that the subsidiary is

⁶⁶ NPRM at ¶ 94.

as "fully separated" as the Commission has proposed, and that it receives no special treatment or other benefits from its affiliation with the ILEC.

B. THE COMMISSION SHOULD ADOPT MEASURES TO REMEDY THE ADVERSE CONSEQUENCES THAT COULD OCCUR IN THE FUTURE IF ITS PROPOSALS FAIL TO CREATE A COMPETITIVE MARKET FOR ADVANCED SERVICES.

While the Commission's proposals -- particularly if they are supplemented as these Comments propose -- may encourage competition in the provision of advanced services, the Commission should recognize that competition may not develop as anticipated.

Until there is demonstrable evidence that effective competition exists, the Commission should monitor market conditions on a regular basis, perhaps through reporting requirements applicable to all advanced services providers or by re-opening this proceeding in two years. To assess the competitiveness of advanced services markets, the Commission could adopt the criteria it previously employed in determining whether the interexchange market was sufficiently competitive to warrant classification of AT&T as a nondominant carrier.⁶⁷ Such criteria would include the respective market shares of competing providers, elasticity of supply, elasticity of demand, and the respective cost structures, sizes, and resources of the competing providers.⁶⁸ In the event that the Commission determines that competition has failed to develop in spite of the measures adopted in this proceeding, it should be prepared to implement

⁶⁷ *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd 3271 (released Oct. 23, 1995).

⁶⁸ *Id.* at 3293.

corrective measures to address competitive imbalances and protect consumers of advanced services.

CONCLUSION

The Commission has taken a reasonable, balanced first step toward accelerating the deployment of advanced services in accordance with the requirements of Section 706. It has proposed measures that should promote competitive entry while offering ILECs alternative approaches for deploying advanced services, each with compelling inherent incentives. The Commission should not stray far from the course it has charted, except to fine tune its proposals in the manner described above.

Respectfully submitted,

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